

12/4/08

COMMISSIONERS
MIKE GLEASON - Chairman
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
KRISTINK. MAYES
GARY PIERCE

BRIAN C. McNEIL
EXECUTIVE DIRECTOR



Phoenix, AZ 85007
 TELEPHONE: (602) 542-4242
 FAX: (602) 594-7470
 E-MAIL: securitiesdiv@azcc.gov

ARIZONA CORPORATION COMMISSION

ORIGINAL

MEMORANDUM

TO: Mike Gleason, Chairman
 William A. Mundell
 Jeff Hatch-Miller
 Kristin K. Mayes
 Gary Pierce

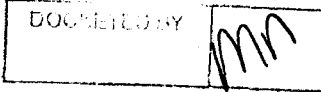
FROM: Matthew J. Neubert
 Director of Securities

DATE: November 18, 2008

RE: *James LeRoy Costello et al S-20627A-08-0485*

CC: Brian C. McNeil, Executive Director

Arizona Corporation Commission
DOCKETED



RECEIVED
 2008 NOV 20 P 4:00
 ARIZONA CORPORATION COMMISSION
 DOCKET CONTROL

Please find attached a proposed Order to Cease and Desist, Order for Restitution and For Administrative Penalties ("Costello Default Order" or "Order"). The Order finds that James LeRoy Costello ("Costello") violated the Arizona Securities Act.

The Costello Default Order is before the Commission because Costello and L. Costello were personally served with a Notice of Opportunity for Hearing Regarding Proposed Order to Cease and Desist, Order for Restitution, Administrative Penalties and Other Affirmative Action ("Notice"). The Notice required them to cease and desist from violating the Securities Act and file an answer within the required period. Neither Costello nor his spouse, Linda S. Costello ("L. Costello") has filed an answer with the Securities Division.

These securities were sold to 15 investors who believed that their funds would be invested in viatical settlement investment contracts ("viaticals"). Costello told investors that they would be repaid on their investments when benefits were paid on their viaticals. However, none of Costello's investors' funds were used to purchase viaticals.

In addition, Costello misrepresented to investors that he was registered to sell securities, he was a certified investment advisor, his investment was guaranteed and risk-free and a state insurance fund would protect his investors against the loss of their investments. Costello misled investors to believe that their investments would be used to purchase viaticals, when in fact Costello used

investors' funds to repay other investors and in some instances pay for expenses not authorized by his investors.

The Order requires Costello and the marital community of Costello and L. Costello to repay investors \$195,000 in restitution and \$75,000 in administrative penalties. The Division recommends this Order because it is in the public's interest and appropriate for the protection of investors.

Originator: Rachel F. Strachan

1 **BEFORE THE ARIZONA CORPORATION COMMISSION**

2
3 COMMISSIONERS

4 MIKE GLEASON, Chairman
5 WILLIAM A. MUNDELL
6 JEFF HATCH-MILLER
7 KRISTIN K. MAYES
8 GARY PIERCE

9 In the matter of:) DOCKET NO. S-20627A-08-0485

10 JAMES LEROY COSTELLO)
11 (CRD# 1501345), a married man,) DECISION NO. _____

12 individually and doing business as)
13 COSTELLO & ASSOCIATES-)
14 FINANCIAL, an Arizona registered trade) **ORDER TO CEASE AND DESIST, ORDER**
15 name, and) **FOR RESTITUTION AND FOR**
16) **ADMINISTRATIVE PENALTIES**
17 LINDA S. COSTELLO, spouse of JAMES) **REGARDING JAMES LEROY COSTELLO**
18 LEROY COSTELLO) **AND LINDA S. COSTELLO**

19 Respondents.)
20)
21)
22)
23)
24)
25)
26)

27 On September 24, 2008 the Securities Division of the Arizona Corporation Commission
28 ("Commission") filed a Notice of Opportunity for Hearing Regarding Proposed Order to Cease
29 and Desist, Order for Restitution, for Administrative Penalties and for other Affirmative Action
30 ("Notice") in the matter against JAMES LEROY COSTELLO, individually and doing business
31 as COSTELLO & ASSOCIATES-FINANCIAL, and LINDA S. COSTELLO.

32 The Notice was personally served upon JAMES LEROY COSTELLO ("COSTELLO")
33 on September 25, 2008. The Notice was served via certified mail upon LINDA S. COSTELLO
34 ("L. COSTELLO") on September 27, 2008. Both COSTELLO and L. COSTELLO failed to file
35 an answer within 30 days of service of the Notice as required by A.A.C. R14-4-305. In addition,
36 neither COSTELLO nor L. COSTELLO requested an administrative hearing within 10 days after
37 receipt of the Notice, pursuant to A.R.S. § 44-1972 (D) and A.A.C. R14-4-306.

I.

FINDINGS OF FACT

1. JAMES LEROY COSTELLO is an individual residing in Maricopa County, Arizona. COSTELLO has transacted business under the trade name "COSTELLO & ASSOCIATES-FINANCIAL" ("CA&F") which was registered with the Arizona Secretary of State on April 26, 1999.

2. COSTELLO and L. COSTELLO may be referred to as the "COSTELLO RESPONDENTS".

3. At all relevant times, COSTELLO and L. COSTELLO were married. COSTELLO acted for the benefit or in further of the marital community.

4. From about May 1999 until March 2007, COSTELLO offered unregistered securities, in the form of promissory notes and/or investment contracts, to investors located in Arizona. At all relevant times, the securities COSTELLO offered and sold were not registered with the Commission.

5. COSTELLO was a registered securities salesman in Arizona from May 23, 1986 until September 15, 2003. However, at all relevant times COSTELLO was not registered with the Commission as a securities salesman.

6. COSTELLO is a licensed insurance producer with the state of Arizona. COSTELLO was initially licensed by the Arizona Department of Insurance to sell insurance products in 1981.

7. In some instances, COSTELLO solicited investors through his insurance business, CA&F. At all relevant times, CA&F was not registered as a securities dealer in Arizona.

8. From about May 1999 until March 2007, COSTELLO raised at least \$195,000 from at least 15 investors. The investors believed they were purchasing viatical settlement investment contracts ("viaticals"). COSTELLO sold to the investors securities, in the form of promissory notes and/or investment contracts.

1 9. COSTELLO solicited investments from investors. COSTELLO told offerees that he
2 would use investor funds to purchase viaticals on their behalf. Specifically, COSTELLO told
3 investors that he worked with someone who identified the securities that COSTELLO would
4 purchase. In addition, COSTELLO represented to investors that he would arrange for collection of
5 payment of benefits on behalf of his investors when benefits were repaid on their investments.

6 10. COSTELLO promised offerees and investors a 50% to 100% return on their
7 investments, including principal and interest. COSTELLO represented to investors in their
8 promissory notes the date their investments would be repaid.

9 11. Although COSTELLO represented to investors that their funds would be used to
10 purchase viaticals, COSTELLO did not provide investors with any documents to evidence they were
11 actually invested in viaticals.

12 12. In one instance, an offeree and investor requested proof (e.g. documents) to confirm
13 that the funds he invested with COSTELLO were actually used to purchase viaticals. COSTELLO
14 did not provide the investor with any documentation to support his claim that he had actually
15 purchased a viatical on behalf of the investor. To date, COSTELLO has not provided his investors
16 with documents to confirm that their funds were actually used to purchase viaticals.

17 13. The only document each of COSTELLO'S investors received was an untitled
18 document which listed the investor's name, the amount of their investment, the terms of their
19 investment, and the date and amount of the investor's return on their investment. The investor and
20 COSTELLO signed the document. At least two investors believed this document to be a
21 "promissory note".

22 14. COSTELLO told at least one offeree and investor that the opportunity to invest with
23 him in viaticals was only available to select individuals.

24 15. An offeree and investor asked COSTELLO to provide the names of other investors
25 and the insurance companies which issued the viaticals. However, COSTELLO did not provide the
26 investor with the requested information.

1 16. On various occasions, COSTELLO made the following representations:

2 a) COSTELLO led an investor to believe that the securities he offered were
3 exempt from registration;

4 b) In at least two instances, COSTELLO represented to offerees that he was
5 registered to sell securities after his registration to sell securities had terminated;

6 c) In another instance, COSTELLO told an investor he was a "certified
7 investment adviser";

8 d) COSTELLO told offerees and investors that their investments with him were
9 risk free and guaranteed; and

10 e) COSTELLO also represented to investors that a state insurance fund would
11 protect them from the loss of their investment.

12 17. None of these representations made by COSTELLO were true.

13 18. In one instance, COSTELLO showed an investor a copy of an insurance policy and
14 represented to the investor that the policy was evidence of the viatical COSTELLO
15 purchased on the investor's behalf.

16 19. To date, COSTELLO has not repaid many of his offerees and investors.

17 20. COSTELLO has given his offerees and investors varying explanations for his failure
18 to repay their investments. In a few instances, COSTELLO told an investor that he was unable to
19 repay his investment because COSTELLO was not receiving payment from the insurance
20 companies for the viaticals.

21 21. In at least one instance, COSTELLO told an offeree and investor that he was unable
22 to repay him because COSTELLO was being investigated and audited by the United States Internal
23 Revenue Service in addition to being sued by an investor.

24 22. Although COSTELLO has not repaid many of his investors, COSTELLO has
25 partially repaid some investors. In spite of this, in at least one instance COSTELLO asked an offeree
26

1 and investor to invest additional funds even though the investor has not been entirely repaid for his
2 initial investment.

3 23. On another occasion, COSTELLO promised an investor a higher return on his
4 investment because of a delay in repaying the investment.

5 24. Although COSTELLO told offerees and investors that he would use their
6 investments to purchase viaticals, COSTELLO did not use the funds to purchase viaticals. Instead,
7 COSTELLO deposited most of the funds he received into his personal bank. In some instances,
8 COSTELLO used investor funds to repay other investors or to pay expenses which were not
9 disclosed to investors.

10 II.

11 CONCLUSIONS OF LAW

12 2. The Commission has jurisdiction over this matter pursuant to Article XV of the
13 Arizona Constitution and the Securities Act.

14 3. The COSTELLO RESPONDENTS did not request a hearing pursuant to A.R.S. § 44-
15 1972 and A.A.C. R14-4-306.

16 4. The COSTELLO RESPONDENTS did not answer the Notice pursuant to A.A.C.
17 R14-4-305.

18 5. COSTELLO offered or sold securities within the meaning of A.R.S. §§ 44-1801(15),
19 44-1801(21) and 44-1801(26).

20 6. COSTELLO violated A.R.S. § 44-1841 by offering or selling securities that were
21 neither registered nor exempt from registration.

22 7. COSTELLO violated A.R.S. § 44-1842 by offering or selling securities while neither
23 registered as a dealer or salesman nor exempt from registration.

24 8. COSTELLO violated A.R.S. § 44-1991 by (a) employing a device, scheme or artifice
25 to defraud; (b) making untrue statements or misleading omission of material facts, and (c) engaging
26

1 in transactions, practices or a course of business which operate or would operate as a fraud or deceit
2 upon offerees and investors. COSTELLO'S conduct includes the following:

- 3 a) COSTELLO misled offerees and investors to believe that the funds they
4 invested with him would be used to purchase viaticals, when in fact COSTELLO did
5 not use the funds for that purpose. Instead, COSTELLO used investors' funds to
6 repay other investors and in some instances pay for expenses not authorized by
7 investors;
- 8 b) In one instance, COSTELLO showed an investor a copy of an insurance
9 policy and represented to the investor that the policy was evidence of the investment
10 COSTELLO has made on her behalf in viaticals, when in fact COSTELLO did not
11 use the investor's funds to purchase a viatical;
- 12 c) COSTELLO misled at least one offeree and investor to believe that he was
13 registered to sell securities, when in fact COSTELLO'S registration to sell securities
14 in Arizona was terminated on September 15, 2003;
- 15 d) In another instance, COSTELLO misled an investor to believe that he was a
16 registered investment adviser, when in fact COSTELLO was not;
- 17 e) COSTELLO misrepresented to an offeree and investor that the investment he
18 offered was exempt from registration, when in fact it was not;
- 19 f) COSTELLO misrepresented to offerees and investors that the viatical
20 investment was guaranteed and risk free, when in fact a guarantee did not exist; and
- 21 g) COSTELLO misrepresented to offerees and investors that a state insurance
22 fund would protect them against the loss of their investments, when in fact the
23 purpose of the state insurance fund is not to protect investors against the loss of their
24 investments, nor had COSTELLO purchased viaticals on behalf of the investors.

25 9. COSTELLO'S conduct is grounds for a cease and desist order pursuant to A.R.S. §
26 44-2032.

10. COSTELLO'S conduct is grounds for an order of restitution pursuant to A.R.S. § 44-2032.

11. COSTELLO'S conduct is grounds for administrative penalties under § 44-2036.

12. COSTELLO acted for the benefit of the marital community and, pursuant to A.R.S. §§ 25-214 and 25-215, this Order of restitution and administrative penalties is a debt of the community.

III.

ORDER

THEREFORE, based upon the Findings of Facts and Conclusions of Law, the Commission finds that the following relief is appropriate, in the public interest and necessary for the protection of investors:

IT IS THEREFORE ORDERED, pursuant to A.R.S. §§ 44-2032, that COSTELLO, his agents, servants, employees, successors, assigns, and those persons in active concert or participation with him, permanently cease and desist from violating the Securities Act. COSTELLO shall not sell any securities within or from Arizona without being registered in Arizona as a dealer or salesman, or exempt from such registration. COSTELLO shall not sell securities within or from Arizona unless the securities are registered in Arizona or exempt from registration. COSTELLO shall not transact business in Arizona as investment advisers or investment adviser representatives unless licensed in Arizona or exempt from licensure.

IT IS FURTHER ORDERED that pursuant to A.R.S. §§ 44-2032, COSTELLO and the marital community of COSTELLO and L. COSTELLO shall pay restitution to the investors shown on the records of the Commission in the amount of ONE HUNDRED AND NINETY FIVE THOUSAND DOLLARS (\$195,000.00) Any amount outstanding shall accrue interest at the rate of 10% per annum from the date of this Order until paid in full. Payment shall be made by cashier's check or money order payable to the "State of Arizona" and placed in an interest-bearing account maintained and controlled by the Commission. The Commission shall disburse the funds on a pro

1 rata basis to investors. Any funds that the Commission determines it is unable to, or cannot
2 feasibly, disburse shall be transferred to the general fund of the state of Arizona. If COSTELLO
3 does not comply with this order of restitution, any outstanding balance shall be in default and shall
4 be immediately due and payable.

5 IT IS FURTHER ORDERED, pursuant to A.R.S. § 44-2036, that COSTELLO and the
6 marital community of COSTELLO and L. COSTELLO shall pay an administrative penalty in the
7 amount of SEVENTY FIVE THOUSAND DOLLARS (\$75,000). Payment shall be made by
8 cashier's check or money order payable to the "State of Arizona". Any amount outstanding shall
9 accrue interest at the rate of 10% per annum from the date of this Order until paid in full.

10 ...

11 ...

12 ...

13

14

15

16

17

18

19

20

21

22

23

24

25

26

1 IT IS FURTHER ORDERED that if COSTELLO fails to comply with this Order, the
2 Commission may bring further legal proceedings against COSTELLO, including application to the
3 Superior Court for an order of contempt.

4 IT IS FURTHER ORDERED that this Order shall become effective immediately.

5
6 BY ORDER OF THE ARIZONA CORPORATION COMMISSION

7 CHAIRMAN

COMMISSIONER

8
9 COMMISSIONER

COMMISSIONER

COMMISSIONER

10
11 IN WITNESS WHEREOF, I, BRIAN C. McNEIL,
12 Executive Director of the Arizona Corporation
13 Commission, have hereunto set my hand and caused the
14 official seal of the Commission to be affixed at the
15 Capitol, in the City of Phoenix, this _____ day of
16 December, 2008.

17
18 BRIAN C. McNEIL
19 EXECUTIVE DIRECTOR

20
21 DISSENT

22
23 DISSENT

24 This document is available in alternative formats by contacting Linda Hogan, ADA Coordinator,
25 voice phone number 602-542-3931, E-mail lhogan@azcc.gov

26 (rfs)